Supreme Court, U.S.
FILED
DEC 23 1997
CLERK

No. 97-852

In The

Supreme Court of the United States

October Term, 1997

EARL W. KAVANAU,

Petitioner,

v.

SANTA MONICA RENT CONTROL BOARD,

Respondent.

On Petition For Writ Of Certiorari To The Supreme Court Of The State Of California

BRIEF *AMICUS CURIAE* OF THE MANUFACTURED HOUSING EDUCATIONAL TRUST OF SANTA CLARA COUNTY, INC. IN SUPPORT OF PETITIONER

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BRIEF OF THE MANUFACTURED HOUSING EDUCATIONAL TRUST OF SANTA CLARA COUNTY, INC., as *AMICUS CURIAE* IN SUPPORT OF PETITIONER[1]

I. Identity and Interest of the Amicus Curiae.

Amicus Curiae, the Manufactured Housing Educational Trust of Santa Clara County, Inc. ("the Trust"), is a trade organization for mobilehome parks.[2] The Trust represents the business interests of park owners, managers, and the manufactured-housing industry within the County of Santa Clara. Currently, the Trust represents 65 mobilehome parks, which include over 1100 mobilehome sites.

The majority of these sites are rent controlled. Rent control ordinances are in place throughout Santa Clara County, and in at least 90 other cities and counties of the State of California. Of 91 rent-control laws, 75 pertain *exclusively* to mobilehome parks. Other forms of rental housing in the same jurisdiction are unregulated.

Cities and counties enact rent regulations as a means of achieving affordable housing, which is a statutory requirement of their General Plans as mandated by the

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[1] The written consent to file this brief in support of the petition was granted by counsel for all parties, and has been filed with the Clerk of the Court.

[2] The Trust has not obtained financial support from any other party or organization to submit this brief. The Trust is a nonprofit, tax-exempt corporation organized under the laws of the State of California, and is located at 777 North First Street, Suite 600, San Jose, California 95112.

California Government Code.[3] Cities and counties also enact mobilehome-space rent regulations to benefit mobilehome residents, who frequently constitute a substantial voting block within the jurisdictions. "[A] primary purpose of rent control is the protection of tenants."[4]

While rent regulations are enacted for the stated legislative purpose of maintaining affordable housing for low-income and elderly citizens, rent controls are granted irrespective of renters' actual income or need for housing support. This broad grant of below-market rents differentiates rent control from other housing subsidies provided or enforced by government.

In the case of mobilehome-space rent control, unless the space control is enacted with a concurrent check on the resale price of the on-site coach, the regulation defeats its legislative purpose by inflating the resale price

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[3] *See* Cal. Gov. Code § 65302 (a) and § 65583. *See also Kavanau v. Santa Monica Rent Control Bd.*, 16 Cal.4th 761, 801 (1997) (*Kavanau II*), J. Baxter *dissenting*, and *citing Birkenfeld v. City of Berkeley*, 17 Cal.3d 129, 160 (1976). As noted by Justice Baxter, "rent control is constitutionally permissible precisely because it is perceived as a means by which the adverse impact on the public of a[n affordable] housing shortage may be cured or mitigated."

[4] *Kavanau II*, 16 Cal.4th at 801, J. Baxter *dissenting*, and *quoting Pennell v. San Jose*, 485 U.S. 1, 13 (1988) ["[O]ne purpose of rent control is 'to protect persons with relatively fixed and limited incomes, consumers, wage earners . . . from undue impairment of their standard of living." *Also Pennell*, 485 U.S. at 13 , "[W]e have long recognized that a legitimate and rational goal of price or rate regulation is the protection of consumer welfare."]

of the residents' mobilehomes. The rent regulation transfers a portion of the market value of the property to the tenant, who is able to collect this premium on resale of the coach.[5]

In the Trust's opinion and experience, the blanket provision of a rent subsidy to all mobilehome residents distorts the mobilehome-housing market: While the price of the coach is inflated as a result of the below-market space rents, the income on the park owner's investment is limited – many times severely. Limiting the park's income constrains the owners' ability to maintain or improve the property, to create new mobilehome spaces, or to sell the park for a reasonable profit.[6]

The Trust believes review of the California Supreme Court's decision in *Kavanau v. Santa Monica Rent Board* should be granted.[7] Unless an adequate just-compensation remedy is enforced against rent regulation that goes too far, local governments have little or no reason not to over-zealously enforce rent controls for the benefit of voting tenants and the paper mandates of their General

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[5] *Compare Richardson v. City and County of Honolulu*, ___F.2d ___, 97 D.A.R. 11, 674 (9th Cir. Sept. 8, 1997) ["The absence of a mechanism that prevents lessees from capturing the net present value of the reduced land rent in the form of a premium, means that the [rent control] Ordinance will not substantially further its goal of affordable owner-occupied housing in Honolulu. . . . The Ordinance thus effects a regulatory taking]".

[6] *Compare Cotati Alliance for Better Housing v. City of Cotati*, 148 Cal.App.3d 280, 293, 295 (1983).

[7] *Kavanau II*, 16 Cal.4th 761 (1997).

Plans. The *Kavanau II* decision eliminates inverse condemnation in the State of California as a means of recovering fair rents confiscated by a local government's enforcement of an unconstitutional rent regulation. The *Kavanau* decision thus forces park owners into federal courts for a just-compensation remedy, and adds to the distortion and decline of the mobilehome-park-housing market.

II. The *Kavanau* Decisions.

In 1988 Mr. Earl Kavanau purchased a 10-unit apartment building in Santa Monica, California. Over the following year, Kavanau improved the property and operated at a loss. He collected rents totaling $43,444 and spent $33,565 operating and maintaining the property. He also spent $82,934 improving the property, and $44,000 servicing debt on the property.[8]

A. *Kavanau I.*

Santa Monica's rent control ordinance provides that a landlord's rents were to be increased to maintain the base year net-operating income (MNOI), defined as gross income less operating costs and expenses. In this manner, the ordinance is intended to maintain the landlord's fair return earned presumably during the base year. At the

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[8] *Kavanau v. Santa Monica Rent Control Bd.*, 19 Cal.App.4th 730, 733 (1993) (*Kavanau I*).

time of Kavanau's apartment-building purchase, the ordinance capped all increases at 12 percent annually.[9]

In November 1989, Kavanau applied to Santa Monica's Rent Board for rent increases on nine of the apartments. The Board's hearing examiner determined Kavanau was entitled to rent increases totaling approximately $35,000 per year in order to maintain a fair return on the apartment complex. Complying with the ordinance's cap on any rent increase to 12 percent per year, the hearing examiner approved a year's rent increase totaling only $5,184. Increases to cover balance of the $35,000 were to be meted out over the next 8 years.[10]

The consequence of the 12 percent limit as applied to Mr. Kavanau was that he was to be denied the current use of the full fair rental income that the hearing examiner determined he was entitled to receive. He was also to permanently lose whatever interest or other income he would have earned on that money. Moreover, for 8 years he would have been frozen at the level of income necessary to earn a fair return in 1989, as any further increase would have been denied on the basis that he was already receiving the full 12 percent cap.[11]

Kavanau petitioned the superior court for a writ of administrative mandate, which the court denied. The Court of Appeal reversed in *Kavanau v. Santa Monica Rent Control Bd.*, 19 Cal.App.4th 730 (1993) (*Kavanau I*).

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[9] *Id.*, 19 Cal.App.4th at 732.

[10] *Id.*, 19 Cal.App.4th at 733.

[11] *Id.*, 19 Cal.App.4th at 733 n.4.

In reversing the lower court, the Court of Appeal observed that a rent regulation's "fair return on investment standard was constitutional as applied only if the regulation affords the Board sufficient flexibility to avoid confiscatory results." Santa Monica's 12 percent limit was so inflexible as to deprive Kavanau of "a just and reasonable return."[12]

The Court of Appeal remanded, instructing the Superior Court to issue a writ "commanding the Board to permit Kavanau to implement the balance remaining of the increases determined by the hearing examiner to be appropriate under the MNOI."[13] This was done. But Mr. Kavanau had lost almost $150,000 in rental income and interest between the time that Santa Monica's Rent Board capped his increase at 12 percent and the time the full rent increase was implemented under the Court of Appeal's order.[14]

B. *Kavanau II.*

The California Supreme Court denied review of *Kavanau I*, and the decision became final. Mr. Kavanau then filed the complaint underlying this petition for certiorari (*Kavanau II*).

Kavanau alleged in his complaint violations of the Due Process Clause of the Fourteenth Amendment, and the Takings Clause of the Fifth Amendment of the United

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[12] *Id.*, 19 Cal.App.4th at 735-36.

[13] *Id.*, 19 Cal.App.4th at 736-737.

[14] *Kavanau II*, 16 Cal.4th at 801, 803, J. Baxter *dissenting*.

States Constitution, as well as the equivalent clauses of the California Constitution. Kavanau sought "just compensation" in the form of lost rental income and interest caused by the temporary application of the 12 percent limit before its invalidation by the Court of Appeal.[15]

The superior court dismissed Kavanau's complaint. Pursuing the inverse condemnation claim, Kavanau appealed. The Court of Appeal affirmed on the basis of its opinion that there had been no taking because Kavanau never lost "all use of his property."[16]

The California Supreme Court granted review. The Court explained, "We granted review in order to consider whether a taking occurred and what, if any, right to just compensation Kavanau might have." The Court disagreed with the Court of appeal that "a property owner must lose all use of his property in order to have a viable inverse condemnation claim." "Nevertheless, [the California Supreme Court concluded] Kavanau is not entitled to maintain an inverse condemnation action, because he may obtain a full and adequate remedy for any interim loss flowing from the due process violation through an adjustment of future rents under the rent regulation process."[17]

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[15] *Id.*, 16 Cal.4th at 767-68.

[16] *Id.*, 16 Cal.4th at 768.

[17] *Id.*, 16 Cal.4th at 767-68.

III. Argument.

A. Enforcement of an unconstitutionally confiscatory rent regulation effects a taking.

The Takings Clause of the Fifth Amendment provides: "[N]or shall private property be taken for public use, without just compensation."[18] Where the government regulates the use of property, "compensation is required . . . if considerations such as the purpose of the regulation or *the extent to which it deprives the owner of the economic use of the property* suggest that the regulation has unfairly *singled out to bear a burden that should be borne by the public as a whole.*"[19] In the words of Justice Holmes, "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking."[20]

In *Kavanau I,* the Court of Appeal finally determined that Kavanau's due process rights were violated because the 12 percent cap deprived Kavanau of rents sufficient to provide a fair return on his property.[21] But in *Kavanau II,* the California Supreme Court exerts tremendous effort to avoid the logical conclusion that Santa Monica effected a

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[18] U.S. Const., 5th Amend.; *as quoted in Yee v. City of Escondido,* 503 U.S. 519, 522 (1992).

[19] *Yee v. City of Escondido, supra,* 503 U.S. at 522, italic emphasis added.

[20] *Id.,* 503 U.S. at 529, *quoting Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393, 415 (1922).

[21] *Kavanau I,* 19 Cal.3d at 735-736; *Kavanau II,* 16 Cal.4th at 767, 779.

taking during the time it enforced the confiscatory rent regulation. The opinion makes little sense.

While seeking to justify its holding that a due-process invalidation remedy for confiscation of fair rents obviates a government taking, the California Supreme Court in *Kavanau II* acknowledges the overlap in due process and takings protections: "[T]he United States Supreme Court has declared that a regulation of property 'effects a taking if [it] does not substantially advance legitimate state interests,' " the *Kavanau II* Court recognizes.[22] The Court also notes, "The similarity of this takings standard to the due process requirement that a regulation 'have a reasonable relation to a proper legislative purpose' . . . supports Kavanau's argument that a due process violation in this context constitutes a taking."[23]

In the case of rent-control regulation, the Court also explains, due process guards against regulations whose methods cause confiscation of the property owner's reasonable return.[24] The takings protection guards against regulation that "goes too far" in controlling rents in order to further goals of government or "public use."[25] What the Court fails to articulate, however, is the simple fact that due process requires invalidation of rent regulations

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[22] *Kavanau II*, 16 Cal.4th at 781, *citing Agins v. Tiburon*, 447 U.S. 255, 260 (1980).

[23] *Id.*, 16 Cal.4th at 781, *citing Nebbia v. New York*, 291 U.S. 502, 537 (1934).

[24] *Id.*, 16 Cal.4th at 770-71.

[25] *Ibid.*

which "go too far" in advancing local government's interest in affordable housing as to cause a confiscation. When a property owner is denied a reasonable return of profit on property held specifically for its rent income, very little economic use of the property remains. This fact suggests that the property owner has, indeed, been unfairly singled out "to bear a burden that should be borne by the public as a whole."[26]

In *Pennell v. San Jose*, the United States Supreme Court recognized that rent control represents "a rational scheme" when it "accommodate[s] the conflicting interests of protecting tenants from burdensome rent increases while at the same time ensuring the landlords are guaranteed a fair return on their investment."[27] In *Birkenfeld v. City of Berkeley*, the California Supreme Court clearly explained:

> . . . . The provisions [of a rent control regulation] are within the police power if they are reasonably calculated to eliminate excessive rents and at the same time provide landlords with a just and reasonable return on their property. However, if it is apparent from the face of the provisions that their effect will necessarily be to lower rents more than could reasonably be considered to be required for the measure's stated purpose, they are *unconstitutionally confiscatory*.[28]

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[26] *Compare Yee v. City of Escondido*, 503 U.S. at 522.

[27] *Supra*, 485 U.S. at 13.

[28] *Supra*, 17 Cal.3d at 165, italic emphasis added; *see also Fisher v. City of Berkeley*, 37 Cal.3d 644, 679 (1984), *citing Cotati Alliance for Better Housing, supra*, 148 Cal.App.3d at 287, 291.

An ordinance which creates a "forced subsidy imposed on the landlord" such that it prevents the landlord from obtaining a reasonable return on property violates the Due Process Clause, which prohibit the taking of property without just compensation.[29] As a commonsense corollary to this constitutional rule, an unconstitutionally confiscatory rent-control ordinance surely must effect a taking during the time it is enforced by government. As recognized by the dissenting justices in this case, there is "no reason in law or logic why a confiscatory rent control regulation, found to be unconstitutional on due process grounds, would not result in a compensable taking if it were nevertheless enforced and a monetary deprivation resulted. [There is] no clearer example of a case where compensation should be paid then where the government has illegally taken or diverted to its own social goals the private property of one of its citizens. Indeed, such a common sense result and statement of principle should need no citation of authority."[30]

B. The Court's conclusion that the only basis of Kavanau's taking claim is the due process violation ignores the economic impact of confiscatory rent regulation.

In its efforts to relieve its cities and counties from the just compensation burden of confiscatory rent regulation,

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[29] *Kavanau II*, 16 Cal.4th at 803, J. Baxter *dissenting and quoting* Justice Mosk *dissent* in *Pennell v. City of San Jose*, 42 Cal. 3d 365, 376-377 (1986).

[30] *Id.*, 16 Cal.4th at 792-93, J. Baxter *dissenting and quoting dissenting* J. Croskey.

the California Supreme Court proposes that "the 12 percent could [constitutionally] . . . be one aspect of a comprehensive scheme that as a whole provided landlords a fair return."[31] The Court's suggestion that *Kavanau I* was wrongly decided, ignores the bare financial reality of the 12-percent-increase. As Santa Monica planned to impose the limit, Kavanau would have had to wait 8 years to bring his rents to the amount deemed a "fair return" in 1989. This financial burden is one few landlords can survive.

Dropping this line of reasoning, the California Supreme Court concedes that *Kavanau I* is a final judgment precluding relitigation. The *Kavanau II* Court thus "accept[s] as true . . . that application of the Rent Board's 12 percent limit on rent increases violated Kavanau's right to due process of law."[32] But the Court then opines, that Mr. Kavanau's allegations "if true, are not sufficient to establish a taking" under "either of the 'two discrete categories of regulatory action' that constitute a taking."[33]

The Court explains that Kavanau did not lose "all economically beneficial or productive use of" his property during the imposition of the 12 percent cap.[34] But the Court does not describe what beneficial economic use is left for a landlord owning rental property which has been

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[31] *Id.*, 16 Cal.4th at 777-78.

[32] *Id.*, 16 Cal.4th at 779.

[33] *Id.*, 16 Cal.4th at 780, *citing Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015 (1992), and *Agins v. Tiburon*, 447 U.S. at 260.

[34] *Id.*, 16 Cal.4th at 780.

controlled below a return of profit. The financial impact of Santa Monica's temporary imposition of a 12 percent cap on Mr. Kavanau was an loss of almost $150,000 in rents and interest income after expenditure of $160,444 in operation and maintenance ($33,565), capital improvements ($82,934) and debt service ($44,000).

Previously in the *Kavanau II* opinion, the Supreme Court listed the Court of Appeal's findings that Kavanau never lost "all use of his property" because he "continued to receive rents and enjoy tax benefits, and he could borrow against the property, hold it for investment, convert it to condominiums, or sell it."[35] These options, however, do not realistically show "beneficial economic use." A tax write-off generally does not provide a return on rental property otherwise run at a deficit. Since the value of mobilehome parks, and other rent-controlled properties, is usually established based on the property's income stream, mortgages against the property or a forced sell of the property do not provide for economic recovery. State and local conversion ordinances frequently prove to be financially prohibitive to conversion of the property to another use.[36] Moreover, the California Supreme Court "disagree[d] that a property owner must lose *all* use of his property in order to have a viable inverse condemnation claim."[37]

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[35] *Id.*, 16 Cal.4th at 768.

[36] *See* Cal. Gov. Code § 65863.7 allowing local governments to impose mitigation assistance to displaced residents as a condition of a mobilehome park closure or conversion.

[37] *Kavanau II*, 16 Cal.4th at 767, italic emphasis added.

The *Kavanau II* Court's pat conclusions that application of the 12 percent limit did not interfere with Kavanau's "primary expectation," did not steer private "resources to permit or facilitate uniquely public functions," or "extinguish a fundamental attribute of ownership" are equally unconvincing.[38] Kavanau's "primary expectation" was to earn income from his property, which is the fundamental attribute of rental property. This expectation and property right to rental income was taken by the city to further its social goals of maintaining affordable housing for its citizenry.

C. Future administrative rent-increase adjudications do not provide an adequate remedy for the taking.

The Fifth Amendment demands that when a government's rent regulation goes too far, just compensation must be paid. "Even if the agency withdraws the regulation," the *Kavanau II* Court recognized, "the property owner may have a right to just compensation for the temporary taking while the regulation was in effect."[39]

The California Supreme Court in *Kavanau II*, however, evades both the conclusion that an unconstitutionally-confiscatory rent regulation must surely effect a taking of the property owner's property during its enforcement, and the just-compensation consequence of

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[38] *Id.*, 16 Cal.4th at 780-781.

[39] *Id.*, 16 Cal.4th at 773, *citing First English Evangelical Lutheran Church v. Los Angeles County*, 482 U.S. 304, 317, 321 (1987).

the taking. The Court concludes, "we need not decide whether a rent regulation that violates a particular property owner's right to due process also constitutes a taking." The Court explains, "assuming it otherwise might, we hold that a remedy for the due process violation, if available and adequate, obviates a finding of a taking."[40] The Court thus finds that "Kavanau is not entitled to maintain an inverse condemnation action, because he may obtain a full and adequate remedy for any interim loss flowing from the due process violation through an adjustment of future rents under the rent regulation process."[41]

As understood by the dissenting justices below, confiscatory rent regulation – regulation that "goes too far" in diverting private property to a government's social goals – should be recognized as a taking, and remedied through just compensation provided by the erring government.[42] But the California Supreme Court relieves local government from just-compensation liability. It does so based upon the speculative theory that confiscated rents may be recovered in the future from existing and incoming tenants.

This Supreme Court has made clear that a property owner should not be required to seek just compensation through piecemeal litigation or unfair procedures.[43] Moreover, "a reasonable, certain and adequate provision

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[40] *Id.*, 16 Cal.4th at 782.

[41] *Id.*, 16 Cal.4th at 767.

[42] *Id.*, 16 Cal.4th at 792, J. Baxter *dissenting with* J. Brown *concurring in dissent.*

[43] *MacDonald, Sommer & Frates v. County of Yolo*, 477 U.S. 340, at 350 n.7 (1986).

for obtaining compensation [must] exist at the time of the taking."[44] But the California Supreme Court's deferred "remedy" of increasing space residents' rents in the future for a local government's past enforcement of confiscatory rent regulation provides a protracted and illusory remedy. The remedy forces park owners to survive further rent loss as they submit to repetitious administrative rent-increase hearings, opposed by tenants and controlled by city and county councils bent on denying increases to maintain a stock of affordable housing.

As stated by dissenting Justice Baxter, "the majority's holding that increasing the allowable rents allowed for plaintiff's rental units is an adequate alternative to an action in inverse condemnation, rests entirely on speculation that plaintiff will someday recover the amount he allegedly lost from past tenants who will remain tenants even though the permitted rent increases will of necessity fix their rents at a figure above that otherwise permitted. It should be apparent to all that this illusory alternative remedy will not and cannot be considered an offsetting benefit that mitigates plaintiff's loss and relieves the Board of its obligation to pay for taking plaintiff's property. The increased rents "remedy" neither precludes a finding that there has been a taking nor satisfies the constitutional command that just compensation be paid when a taking occurs."[45]

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[44] *Williamson County Regional Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 194 (1985), as *quoted in Del Monte Dunes at Monterey v. City of Monterey*, 920 F.2d 1496, 1507 (9th Cir. 1990).

[45] *Kavanau II*, 16 Cal.4th at 804, J. Baxter *dissenting with* J. Brown *concurring in the dissent.*

D. *Kavanau II* makes rent-controlled property owners' inverse condemnation claims ripe for federal adjudication.

In *Agins v. City of Tiburon*, the California Supreme Court held that property owner's had no right to bring inverse condemnation actions for a regulatory taking of property.[46] In *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, this Supreme Court expressly disapproved the *Agins* rule prohibiting property owners from pursuing inverse condemnation claims.[47] But after *Agins* and before *First English*, California property owners regulatory takings claims were made ripe for federal adjudication due to the fact a just compensation remedy did not exist in California at the time the claims arose. Thus, the Ninth Circuit regularly held, "Because no remedy in inverse condemnation existed at the time of the alleged taking in this case, the district court erred in ruling that the [property owners] were required to pursue state compensation procedures before filing for federal court review."[48]

Where a state does not provide a compensation remedy for government takings or where the remedy is

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[46] *Supra*, 24 Cal.3d 266, 275-77, 157 Cal.Rptr. 372, 375-76, (1979) (*in banc*), *affirmed on other grounds*, 447 U.S. 255 (1980).

[47] *Supra*, 482 U.S. at 310-311.

[48] *Hoehne v. County of San Benito*, 870 F.2d 529, 533-34 (9th Cir. 1989); *accord Del Monte Dunes at Monterey v. City of Monterey*, *supra*, 920 F.2d at 1507.

inadequate, a property owner's claim for inverse condemnation is ripe for federal adjudication.[49] In *Kavanau II*, the California Supreme Court has foreclosed property owners from seeking just compensation for takings caused by the enforcement of confiscatory rent regulations.[50] Just as Mr. Kavanau is turning to this Supreme Court for relief from the denial of just compensation in this instance, mobilehome parks and other rent-controlled property owners will turn to federal courts for a fairer resolution of their right to receive a fair return through enforcement of an actual and adequate just-compensation remedy.

IV. Conclusion.

Unless Fifth Amendment Takings Clause scrutiny is provided by the courts – and enforced with a just compensation remedy – local governments have little reason to do other than regulate rents at levels that put the property owner's fair return to the government's use. In the context of mobilehome-space rent control, the end result of this confiscatory rent-control regulation is a depletion of mobilehome park housing as parks are driven from business, and an increase in federal court litigation. As a representative of the mobilehome park industry, the Trust respectfully urges this honorable

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[49] *Ibid.*

[50] 16 Cal.4th at 767.

United States Supreme Court to accept Mr. Kavanau's petition for review.

Dated: December 23, 1997.

Respectfully submitted,

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